

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of John Kern on May 5, 2006

DATED: May 27, 2006

On Friday, May 5, 2006, Benito Romano interviewed John Kern in Willkie Farr & Gallagher LLP's ("Willkie") capacity as counsel to the Audit Committee. Mr. Kern was represented by counsel, Theresa McAteer of McAteer & McAteer. Also in attendance were William Haegele and Erick Bell of KPMG, Sharon Blaskey and Heath Rosenthal of Willkie. The interview took place in a conference room on the third floor of the San Diego City Administration Building and lasted approximately three hours.

The following memorandum reflects my thoughts, impressions and opinions regarding our meeting with Mr. Kern, and constitutes protected work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

At the outset of the interview, Mr. Romano explained to Mr. Kern that Willkie represents the Audit Committee created by the City Council. Mr. Romano also stated that although the material discussed during the interview would be treated as privileged, either through the attorney-client privilege or the work product doctrine, in the likely event that Willkie issues a report, the privilege will be lost. In addition, the City can waive the privilege even if no report is written. Mr. Romano further explained that because Willkie is cooperating with other investigations, we may be sharing information we learned with the U.S. Attorney's Office, the SEC and the City's outside auditor, KPMG, and therefore Mr. Kern should be as accurate and truthful as possible. Mr. Romano also asked that the contents of the interview be kept confidential, and emphasized that Mr. Kern could seek clarification of a question or issue at any time.

Background

Mr. Romano asked Mr. Kern to discuss his background in City government. Mr. Kern stated that he was in the United States Navy from 1964 through 1968. He became a reporter for the Union Tribune in 1971 and worked there until he took the job of press secretary for California Assembly Minority Leader Paul Priolo in 1977. He remained in that position until he became Council member Larry Stirling's chief of staff in 1979. Mr. Kern also worked as Dick Murphy's chief of staff from 1981 through 1985 when Mayor Murphy was on the City Council, with a few breaks from that job within that timeframe. He then became Council member Judy McCarty's chief of staff and held that job until 1989. At that point he opened his

own private business. However, Mr. Kern returned to politics and government when Mayor Murphy asked Mr. Kern to manage his first campaign in 2000, and he subsequently became Mayor Murphy's chief of staff. Later in the interview, Mr. Kern stated that he did not want the chief of staff job at first, but Mayor Murphy needed him because he said "there was no one else to do it." In all, Mr. Kern stated that he had 14 actual years of city service that included ten years in service to Council members and four years working for Mayor Murphy when he was the mayor. He also claimed to be the longest serving chief of staff to elected officials in San Diego history. After leaving city government, Mr. Kern reopened his political and public affairs consulting company that he started in 1989.

Mr. Romano then asked whether Mr. Kern kept in touch with Mayor Murphy, and Mr. Kern stated that he did. Mr. Romano questioned whether Mr. Kern talked to Mayor Murphy about this interview. Mr. Kern stated that he had not.

Mayor Murphy's Staff

Mr. Kern said that Mayor Murphy's office consisted of people who dealt with scheduling, press, community relations, and protocol. He also said that there was an assistant who was in charge of appointments. Mr. Kern listed the following people from Mayor Murphy's office: Dennis Gibson (policy advisor), Tom Story (policy advisor), Rudy Fernandez (business-related role), Steve Heindal (community relations team and financial issues), Bill Baber (aide) and Carol Bonavolant (Mayor Murphy's personal assistant).

Mr. Kern said that there was a Monday morning staff meeting during which the staff reported on what they were doing and reviewed Mayor Murphy's agenda. Mr. Romano asked who reported directly to the Mayor. Mr. Kern explained that every staff member could report directly to Mayor Murphy. However, Mr. Kern stated that few people talked to the Mayor before talking to him first, except for Mr. Story, Mr. Baber, Mr. Gibson and the person in charge of the press, all of whom reported directly to Mayor Murphy.

Mr. Romano asked Mr. Kern what his role was as Mayor Murphy's chief of staff. Mr. Kern responded that he served as the troubleshooter and "political go-to person." He also was the recipient of phone calls from people who wanted to speak with Mayor Murphy and needed to talk to someone immediately. Mr. Romano asked how mail was distributed in Mayor Murphy's office. Mr. Kern said that incoming mail went to the receptionist and was then distributed to the staff accordingly.

Mayor Murphy's First Mayoral Campaign

Mr. Romano stated that he was interested in two of Mayor Murphy's "Ten Goals" set out in his first campaign. The first was the creation of an ethics commission, and he asked Mr. Kern to explain how the idea for that goal came about. Mr. Kern said that the ethics commission was one of the turning points of the Mayor's 2000 campaign. He explained that Mayor Murphy's opponent, Ron Roberts, had voted against creating an ethics commission when he was on the City Council, but then raised the issue of ethics in one of his campaign pieces. Mr. Kern said that Mayor Murphy was a "golden" ethical candidate who campaigned that he wanted to give the ethics commission subpoena power, make Council member Valerie Stallings a member of the ethics commission, and questioned why Mr. Roberts did not want one.

Mr. Kern stated that there were originally nine goals, but Mayor Murphy added an extra goal because he liked round numbers. Mr. Romano asked what the extra goal was. Mr. Kern replied that the tenth goal that had been added on was "energy independence," which he described as including green building and alternative energy initiatives. He explained that the idea was to use the annual State of the City address to report on the status of how far the City had come in accomplishing the Ten Goals. Later in the interview, Mr. Romano asked whether all of the Ten Goals were issues Mayor Murphy discussed in his campaign, and Mr. Kern stated that they were. Mr. Kern added that Mr. Roberts said that he could accomplish Murphy's Ten Goals better than he could.

Mr. Romano asked Mr. Kern his political affiliation and the affiliations of Mayor Murphy and Mr. Roberts. Mr. Kern stated that he, Mr. Murphy and Mr. Roberts were all Republicans. He added that the mayoral race is non-partisan, and that all candidates in 2000 were Republicans, except possibly Council member George Stevens. Mr. Romano asked Mr. Kern how he came to work for Mayor Murphy. Mr. Kern explained that when Council member Sterling ran for state assembly in 1980 and won, the Council appointed Mayor Murphy to fill the vacancy in late December or early January and he eventually became his chief of staff. (Mr. Kern explained that Council members could be appointed at that time.)

Mr. Romano next asked how business-friendly constituents would vote when two candidates are Republican. Mr. Kern responded that Mayor Murphy was not expected to win the race. Mr. Roberts had sixty percent "name id" and fifteen percent of the polls. Mayor Murphy had the support of the 7th Council district, the military, youth sports teams, and the churches. (Mayor Murphy is a Born-Again Christian.) Mr. Kern said that Mayor Murphy was in 6th place in the polls on the night before the primary, but he ended up winning the primary by 166 votes.

Mr. Kern went on to recount what occurred in the general election race between Mayor Murphy and Mr. Roberts. In addition to the groups he named earlier, Mr. Kern also said that Mayor Murphy had the support of environmental groups and the Union Tribune. Mr. Kern stated that all of the mayoral candidates except for Mayor Murphy supported gay marriage in the primary, and that helped Mayor Murphy. Mr. Kern said that Mr. Roberts had the support of the more Democratic communities, including blacks and homosexuals. However, Mr. Kern said that Mr. Roberts "turned" on Padres' owner John Moores, which hurt his campaign. He explained that Mr. Roberts got caught taking planes on company funds and blamed his daughter for those incidents. Mr. Roberts also blamed Mr. Morse for the problems that occurred with Council member Valerie Stallings.

Mr. Kern discussed campaign issues that involved airports. Mr. Roberts had friends run campaign advertisements saying that Mr. Murphy wanted to move an airport to Miramar. However, people who wanted the airport moved voted for Mayor Murphy and Mr. Roberts lost his own district as a result. A second airport issue involved a cargo airport in Brown Field. During the election, Mayor Murphy was originally supportive of this airport. (Mayor Murphy later changed his position after receiving an FAA report.) Mr. Kern explained that having an airport in Brown Field would require the Mexican government to agree to shut down one of its airports for a couple hours each day. Therefore, the Mexican government was not happy about this idea. There was no effective support group for the airport, with the exception of some very wealthy individuals.

Mr. Romano brought the conversation back to the Ten Goals. He asked Mr. Kern if he had helped Mayor Murphy write his speech that unveiled the Ten Goals, and Mr. Kern said that he did. Mr. Romano then said that the second goal he was interested in discussing was the completion of the Padres new ballpark (the "Ballpark"). Mr. Romano asked Mr. Kern to describe the state of the Ballpark when Mayor Murphy took office. Mr. Kern explained that the Ballpark was just a hole with rusty girders. He stated that the Ballpark project was one of the defining features of Mayor Murphy's first two years in office and took up a lot of their time. Mr. Kern noted that it was probably not until late summer of 2001 that he was convinced that they had to finish the Ballpark. He explained that the Ten Goals had to make financial sense for the City, and at one of the early meetings on the Ballpark he said that the City was prepared to walk if the finances were not there.

The Blue Ribbon Committee & The Pension Reform Committee

Mr. Kern said that Mr. Roberts had tried to make the state of the City an issue in the campaign by claiming that he could fix the City's economic problems. Consequently, Mr. Kern recommended to Mayor Murphy that he form the Blue Ribbon Committee ("BRC") after the election to determine as quickly as possible if Mr. Roberts had been correct in asserting that the City was not in good fiscal condition. Mr. Romano asked whether Mr. Kern had any reason to think the City was in a bad state. Mr. Kern replied that San Diego historically was considered the best managed City in the United States and received an award in 2001 for being the best managed city. He had no indication that there was anything systemically wrong with the City. Mr. Kern then noted that the big issue with the BRC Report were the problems with the City's infrastructure, which Mayor Murphy began to address after the BRC Report was issued.

Mr. Romano asked who came up with the idea for the BRC. Mr. Kern stated that he suggested the BRC as far as he could remember, although he said that maybe the creator was Mayor Murphy. Mr. Romano then asked why they did not ask the City Manager to investigate the state of the City, or go outside of the government to find answers if San Diego received an award for being the best managed city. Mr. Kern responded "because it was a political issue" that had been raised in the campaign. He also added that, at that time, the City Manager was being attacked. Mr. Kern thought that Mr. Roberts called for City Manager Michael Uberuaga to be fired during the election.

Mr. Romano asked whether Mr. Kern knew Mr. Uberuaga prior to Mayor Murphy's election. Mr. Kern responded that he and Mayor Murphy had briefings with Mr. Uberuaga when Mayor Murphy first got elected. He added that when Mayor Murphy and Mr. Kern met with Mr. Uberuaga in Mr. Uberuaga's office at that time, Mr. Uberuaga was surprised to see that Mayor Murphy and Mr. Kern already knew so many people in City government. Mr. Romano asked whether Mr. Kern had any sense of Mr. Uberuaga's capabilities prior to this point, and he stated that he did not.

Mr. Romano next asked what information Mr. Kern or Mayor Murphy received regarding the progress of the BRC Report. Mr. Kern responded that he did not recall specific meetings, but noted that a couple of times Ed Ryan (City Auditor and Comptroller) and Patricia Frazier (Deputy City Manager) talked to him about the BRC. However, Mr. Kern told them that the BRC should report directly on whatever they found. Mr. Kern stated that the BRC briefed Mayor Murphy in early 2002. Mr. Romano asked if Mr. Kern was at the Rules Committee

meeting in 2002 in which the BRC Report was presented; Mr. Kern stated that he did not recall but stated that he may have gone. He added that there had been a pre-briefing of Mayor Murphy by the BRC before its presentation to the Rules Committee. Mr. Romano asked if the entire BRC attended Mayor Murphy's pre-briefing. Mr. Kern responded that Joe Craver, April Boling, and some other committee members were in attendance, but not the entire BRC. Mr. Romano then asked Mr. Kern if he was at that meeting. Mr. Kern said that he did attend, but he was not sure if he was at the meeting for its entire duration.

Mr. Romano asked about Mayor Murphy's reaction to the BRC Report. Mr. Kern responded that "it was classic Murphy." Mr. Kern recalled that the BRC Report had four recommendations, including issues related to the pension, City infrastructure and "maybe" reserves. He explained that Mayor Murphy set it up so that the BRC could present their findings to the Rules Committee and have a public hearing on its recommendations. Then, each recommendation would be addressed and there would be a solution laid out for each of them.

Mr. Romano then directed the conversation to the portion of the BRC Report that dealt with issues relating to the City pension system. Mr. Romano stated that part of the BRC Report said that the pension had been underfunded for some time and expenses had been put off to the future and asked who presented that portion of the BRC Report. Mr. Kern responded that Mr. Ryan spoke and Richard Vortmann (the BRC member who oversaw pension issues) delivered the pension part of the Report. Mr. Romano said that the BRC Report painted a negative picture of the pension system and he asked whether anyone was saying that this was a big problem that needed to be dealt with. Mr. Kern responded no. He explained that when he had worked for Council member Stirling in 1979, the Council almost censored Council member Stirling for saying that the SDCERS Board had problems because he was not supposed to interfere with the affairs of the Board. Mr. Kern stated that at the time, the pension was 68 percent funded, but "*nobody* cared" because pensions were known to be underfunded. Mr. Kern also added that this thinking was the genesis for the Waterfall and 13th Check and noted that he and Council member Sterling did research that lead to 13th Check. Therefore, Mr. Kern stated that when he learned that the pension was 98 percent funded when Mayor Murphy took office, he "shut down" and did not pay attention to it because of his previous experience working for Council member Sterling. He also added his recollection that the focus of the BRC Report was the City's infrastructure, not the pension.

Mr. Romano posited that the BRC Report was inaccurate for not having the correct numbers about the pension system. Mr. Kern disagreed. Mr. Kern stated that the BRC report was written in January and said the Unfunded Accrued Actuarial Liability ("UAAL") was 97 percent and Rick Roeder (SDCERS Actuary) issued a report in February stating that the UAAL was 89 percent. However, Mr. Kern said that the Board did not accept Mr. Roeder's report until June, and that is why the pension numbers in the BRC Report were accurate.

Mr. Romano asked why there had been a delay in the issuance of the BRC Report. Mr. Kern responded that he had only later learned that the BRC Report was scheduled for completion in September 2001, but the terrorist attacks that occurred on September 11 delayed filing of report. He added that he knew that it is hard to believe that the terrorist attacks on the East Coast would stop the issuance of the BRC Report, but he explained that the City was affected by the attacks. Mr. Kern said that memorials had to be put together, weekly "Chinese

Fire drills" occurred, and security issues, such as threats of a bombing at the San Diego Zoo, arose.

Mr. Kern said that he only talked with Mr. Vortmann once. He said that he finally understood the problem with the pension system after a three hour meeting with members of the PRC, including Ms. Boling and Mr. Vortmann. Mr. Kern asked Mr. Vortmann if it was too late to fix the problems with the pension system. Mr. Vortmann responded that it was not, but that the City had to act. Mr. Kern said he did not recall seeing any of the letters written by Mr. Vortmann to Mayor Murphy and the Council about the BRC Report around the time of City Attorney Michael Aguirre's first interim report regarding the pension crisis. Mr. Kern said that in July 2004, Paul Maco of Vincent & Elkins ("V&E") asked him if he had documents relating to the pension issues that were under investigation. In response, Mr. Kern shipped all of the documents he had to Mr. Maco. Mr. Kern stated that Mr. Aguirre wrote in his first interim report that Mayor Murphy hid the facts relating to the BRC. Mr. Kern had not even thought about the BRC being problematic until then, so he looked in his BRC file and saw a letter from Mr. Vortmann with an attached note that said "John, here is the letter you wanted." Nevertheless, Mr. Kern still did not recall seeing that letter or any other letter from Mr. Vortmann, and he believed that the Vortmann letter with the attached note was not the letter discussed in Mr. Aguirre's report. Mr. Romano asked whether anyone had made Mr. Kern aware that Mr. Vortmann wrote to the Mayor about problems with the BRC Report. Mr. Kern replied that he had no recollection of having seen Mr. Vortmann's letter or even discussing it. He added that even if he had seen it, he would have thought that issues with the BRC were being handled by the Rules Committee process that had been set up by Mayor Murphy.

Mr. Romano asked whether there had been a concern about the effect of the BRC Report on the Ballpark financing. Mr. Kern responded that he had sat in on approximately 60 Ballpark meetings, and he did not recall the BRC Report being delayed because of the Ballpark. He added that if Mayor Murphy heard a suggestion to delay the BRC Report because of the Ballpark bonds his reaction would have been "hell no." However, Mr. Kern noted that Mr. Ryan and Ms. Frazier were "obsessed with the financial ratings of the City." Thus, he thought it was possible that they slowed down the BRC Report because of the Ballpark financing, although he did not see that possibility at the time the BRC Report was being delayed.

Mr. Romano next showed Mr. Kern Exhibit 1, Minutes from the BRC meeting held on August 31, 2001 (Mr. Ryan, Terri Webster (Assistant Auditor and Comptroller) and Mayor Murphy were also present) and Exhibit 2, handwritten notes on paper with Ms. Webster's letterhead. Ms. Webster's notes stated "8-31-01," "Brought up by committee" "timing + content of report," and "don't want to mess w/ ballpark bonds." Mr. Romano read from the note "I don't want to mess with the ballpark bonds." Mr. Kern responded, "Wow! I stand corrected. I guess Vortmann knew what he was talking about." Mr. Romano asked whether Mr. Kern ever attended any BRC meetings; he stated that he did not. Mr. Kern added that he believed Mr. Gibson went to all of those meetings. He stated that Mr. Gibson never came to him about the BRC Report being delayed because of the Ballpark bonds, but in retrospect he wished he had. Mr. Kern recalled that the Ballpark had been delayed for legal reasons.

Mr. Kern then started to discuss Charter Section 22. He explained that it meant for years that elected officials could not deal directly with City staff. Mr. Kern said that Council member Stirling and Mayor Murphy both had been threatened for attempting to do just that. Mr.

Kern said that the purpose of Section 22 was to enable the City Manager's staff to solve problems before those problems reached closed session. Mr. Romano asked whether Mayor Murphy could have discussed closed session with Mr. Kern. Mr. Kern said that Mayor Murphy did not talk to him about closed session. He stated that Mayor Murphy also did not tell his wife anything about closed session because he was a judge and a lawyer. However, approximately three or four times a year, Mayor Murphy told Mr. Kern something that happened in closed session that he believed Mr. Kern needed to know about. Mr. Kern later stated that he believed that he knew whatever Mayor Murphy knew in most cases. He also added that he could have been briefed on issues discussed in closed session if he wanted to. Mr. Kern added that the idea of closed session was that there was "no bad news" to report, and if you bring bad news you should come with a solution. He stated that, in the most important matters, Mayor Murphy was entirely dependent on the City Manager.

Mr. Romano asked whether the pension system was an issue in Mayor Murphy's 2004 State of the City speech. Mr. Kern stated that his one argument with Mayor Murphy was over the 2004 State of the City speech. Mr. Kern said that he thought it should have included a longer discussion about the pension, but Mayor Murphy said it should not and wanted to concentrate on the Ten Goals.

Mr. Romano then inquired about the referral to the SDCERS Board for a response to the BRC Report. Mr. Kern recalled such a referral, but did not recall that it was he who made it. Mr. Romano then stated that the BRC Report recognized underfunding for years and asked where the BRC got that information. Mr. Kern replied that he was not sure. Mr. Romano next asked why the response was referred to SDCERS if the problem was a funding issue. Mr. Kern said that there was not a meeting at the time to discuss referring it to the Board. He explained that Mayor Murphy thought that he needed to hear the other side. Mr. Romano asked if Mayor Murphy had expressed that to him, and Mr. Kern responded that he knew how Mayor Murphy would have responded simply because he knew him. Mr. Romano then asked why the response from the SDCERS Board had been delayed. Mr. Kern stated that he did not recall a sense of urgency to get the Board's response, but he did not know why the response was delayed.

Mr. Kern said he had attended the Rules Committee meeting in which the SDCERS Board presented its response to BRC Report. Mr. Kern added that he did not have that much more knowledge about the pension underfunding at that point. Later in the interview, Mr. Romano showed Mr. Kern Exhibit 3, a SDCERS presentation responding to the BRC Report. Mr. Kern said that he had no idea if it was the report he previewed prior to the Rules Committee meeting in which the SDCERS response was presented.

Mr. Romano noted that both the SDCERS Board and the BRC had told him and Mayor Murphy that there was a funding issue. Mr. Kern responded that the healthcare insurance liability number announced at that Rules Committee is what had stood out to him. He recalled thinking, "where the hell did that come from?" Later in the interview Mr. Romano showed Mr. Kern Exhibit 4, a February 10, 2003 e-mail from Ms. Webster to Lawrence Grissom (SDCERS Administrator) and read Ms. Webster's comment that "In the meeting with Kern you said the health \$1 billion projection was based on a 5% annual increase in cost. Page 9 of the report leads the reader to believe it's based on a 10% increase. What is it?" Mr. Kern said Ms. Webster was probably discussing a meeting with the SDCERS Board prior to their Rules Committee meeting in February 2003 in which the SDCERS Board responded to the BRC Report. He noted that the

Rules Committee meetings occurred on Wednesdays and the e-mail said that Wednesday "will be fun!" Mr. Kern said he had no recollection of that meeting or why he would have asked the question on healthcare. However, he noted that he thought that it was the Rules Committee Meeting itself in which the \$1 billion number popped out at him.

Mr. Romano asked whether there had been any sense of urgency in dealing with the pension funding problem. Mr. Kern explained that the Rules Committee told the City Manager to come back with report in 60 days discussing how to fix the pension problem, but the City Attorney stopped the City Manager from writing a report. Mr. Kern said that he was not aware of any meetings in the Mayor's office where funding options were discussed. He added that if such options had been discussed at a Rules Committee meeting, either Mr. Baber or Mr. Gibson would have been in attendance. However, Mr. Kern stated that he recalled that the meeting in which the City Manager was to respond to the SDCERS Board's response to the BRC Report was cancelled by the City Attorney's Office because of the *Gleason* lawsuit. Later in the interview Mr. Kern said definitively that the City Manager's report was prevented from being written because the City Attorney's Office was concerned about litigation.

Mr. Kern added that he had screaming matches with Mr. Girard about the City's ability to discuss pension issues. Mr. Romano asked whether work should have continued on the pension issues even if it couldn't be publicly discussed. Mr. Kern responded that he had no answer for that question. He explained that he had been asking for information on the pension system and Lamont Ewell (Assistant City Manager) brought him a white binder containing "garden variety" documents that Mr. Ewell said he should see. However, Mr. Kern stated that Mr. Ewell took the binder away from him an hour later per the City Attorney Office's directive. He said that Mr. Ewell stated to him, "we have the information but you can't have it because you'll be at risk." Mr. Kern later added that Mr. Ewell seemed almost scared about what he had been told by the City Attorney's Office as to why he had to take the binder back. Mr. Romano asked if Mr. Kern looked at the documents in the binder. Mr. Kern said that he did not get a chance to take a good look at them. Mr. Romano then questioned whether any of the documents in the binder had been created specifically for Mr. Kern. Mr. Kern responded that he had thought that only a table showing benefits that had been granted was been created for him; it was probably created in the spring of 2003. He did not recall if the other documents were created just for him.

Mr. Romano asked Mr. Kern why he did not ask Mr. Gibson for information regarding the pension underfunding. Mr. Kern said that he had asked Mr. Gibson for information regarding the vote that occurred in 2002 (presumably relating to MP-2), and that is when he found out that Council member Donna Frye had voted for the underfunding. He stated that after he saw that information he became interested in the pension funding issue and began doing research on his own because he did not trust anyone to provide him with accurate information. Mr. Romano asked why he and Mayor Murphy did not meet to discuss the pension underfunding. Mr. Kern replied that his educated guess was that Mayor Murphy thought that the SDCERS Board solved the problem in 2002 through the adoption of MP2. Mr. Kern noted that Mayor Murphy said in his interview with V&E that it would have been "disingenuous" to discuss the pension issue because it had been solved. Mr. Kern said that he did not know why Mr. Murphy used the word "disingenuous," and noted that the major issue at that time was retiree healthcare.

Mr. Romano then showed Mr. Kern Exhibits 5 and 6, two draft memoranda from Mr. Uberuaga to Mayor Murphy and the Council, both dated "June ___, 2003," discussing a report on issues and options related to the City's pension funding requirements. Mr. Kern replied "wow," and said that he was almost certain that he had not seen those memoranda. Mr. Romano noted on page 10 of the memorandum indicated as "Report I" (Exhibit 5) the presentation of certain funding options and asked whether this memorandum was available at the time the PRC was created. Mr. Kern said that it was not. Mr. Kern did not recognize the handwriting on the document. Mr. Romano then directed Mr. Kern to the first page of the other memorandum, which was marked as "Report II" (Exhibit 6) and asked if Mr. Kern recalled it. Mr. Kern replied that he did not recall that memorandum.

Mr. Romano next asked how the PRC could be created in light of the *Gleason* litigation, and Mr. Kern responded that he did not know. He said that Mr. Girard tried to get Mr. Kern to stop the creation of the PRC because he had been concerned that what they might say would concern the *Gleason* lawsuit. Mr. Kern guessed that maybe the answer was that the PRC was not an official organ of the City. He said that the City had to do something. Mr. Kern went on to add that to this day he does not think that the pension system is the City's worst problem. He explained that Mayor Murphy's administration was constantly being attacked, and only one side of the story was being told. Mr. Kern said that the City can pay benefits for 15 years without putting another dime into the pension system, but the only information that got out to the public were Diann Shipione's allegations and articles from the Union Tribune. The City was not saying anything in its defense. He wanted to, but Mr. Girard said that they could not respond. Thus, Mr. Kern reiterated that one purpose of the PRC was to get the City's voice heard through a theoretically independent voice.

Mr. Romano noted that the PRC was the third time the pension issue had been studied. Mr. Kern responded that the PRC was actually the first time the pension was studied on its own. Mr. Kern stated that he had expected the PRC to have completed its report sooner than they did, but he was not sure if the PRC had been given a deadline for completion. He added that some people expressed concern that the PRC Report would be finished too quickly. Mr. Romano asked who had expressed such concern, and Mr. Kern responded Mr. Ryan, Ms. Frazier and Mr. Girard. He explained that he thought they feared that the PRC would write about issues that it should not have been addressing. Mr. Kern stated that he almost felt as if those people came through his office to hint that they wanted him to tell the PRC to slow down to "see if he would bite." Mr. Romano asked if Mr. Kern had a sense of what the sensitive spots of the PRC Report were that concerned people; Mr. Kern stated that he did not. Mr. Kern said that the City Attorney's Office refused to give the PRC some materials.

Mr. Kern added that he had enormous faith in the PRC and never understood the reluctance to accept the fact that there was a market downturn, because the market could go back up. Mr. Kern also said that Ms. Boling told him that it was not a problem if the gap between what the City owed and what it could pay remained constant, but Mr. Kern said "all of a sudden" he realized that the gap could not get too big. He began to write a memorandum to Mayor Murphy in 2004 to explain what he had learned, but he never finished it. Mr. Romano asked whether Mr. Kern remembered getting the PRC report and reading it. Mr. Kern said that he was sure that he read it, but he could not say that he remembered getting it. Mr. Romano noted that the PRC Report tried to quantify the various causes of the pension underfunding. He stated that

people said that the underfunding was caused by investment returns, and that is what Mr. Roeder had said for years, but the PRC Report only attributed six percent to investment returns.

Mr. Romano showed Mr. Kern Exhibit 7, the PRC Report, and Mr. Kern said that it "looked familiar" Mr. Kern was not sure what net actuarial losses were. Mr. Kern explained that he had been focusing on whether the City could get the pension to be 90 percent funded by sticking with the PRC's plan. He did not concentrate on the reasons for the underfunding because it was already a problem; the perception was that the City underfunded the pension and everyone involved were "crooks." Mr. Kern said that the solution was to move forward. He stated that the pension was not the City's biggest problem and they could fix it. Mr. Romano asked whether Mr. Grissom represented to Mr. Kern that the fund could still pay benefits even if it did not earn anything more. Mr. Kern responded that Mr. Grissom said that the fund had \$3 ½ billion in assets that could be used to pay benefits for 15 ½ years. However, Mr. Kern recounted how Mr. Grissom had told him at first that the fund could pay 20 years of benefits and then four months later Mr. Grissom and Paul Barnett (Deputy SDCERS Administrator) told them it could only pay 16 years worth of benefits. This raised a "red flag" in Mr. Kern's mind which caused him to go talk with Mr. Murphy about the situation.

MP2

Mr. Kern stated that he did not become aware of MP-1 until early 2003, and he was not aware that it was called MP-1 or that MP-2 was called MP-2 until Ms. Shipione made her allegations. Mr. Kern also stated that the first time he became aware of the pension issue was when he heard Ms. Shipione's speech. He added that Mr. Ewell did not want to sign the response to Ms. Shipione's letter, but he could not recall why. Mr. Romano then asked if he knew who drafted Mr. Ewell's response. Mr. Kern replied that he was not sure who drafted it, but he guessed that it was probably Mr. Herring or Ms. Lexin and noted that Mr. Uberuaga probably gave Mr. Ewell the task to sign it.

Mr. Romano showed Mr. Kern Exhibit 8, a December 6, 2002 memorandum from Mr. Ewell to Mayor Murphy and the Council that responded to Ms. Shipione's allegations. Mr. Kern said that he did not have a recollection of reading either Ms. Shipione's or Mr. Ewell's letter. Mr. Kern did not recall receiving the Ewell memorandum or reading it very carefully. He stated that he possibly just read the concluding paragraph and felt that he did not need to know anything else. Mr. Romano then asked whether the fact that Mr. Ewell displayed discomfort with having had signed the response required him to inquire further. Mr. Kern said no and explained that it was his sense that it had been the case that Mr. Ewell was upset because he got delegated the less desirable jobs. However, Mr. Kern stated, "Again, if I knew then what I know now, there are a dozen times I should have said or done something." Mr. Romano pointed out that the letter indicated that Ms. Lexin was the author. Mr. Kern stated that he did not believe at the time he knew that she had written it. Mr. Romano asked what the reaction to Ms. Shipione had been after Mr. Ewell responded to her allegations. Mr. Kern stated that he did not recall dealing with Ms. Shipione at that time. However, he remembered that people tried to destroy her credibility by saying she was caught shoplifting at age 20, which he thought to be irrelevant.

Mr. Kern said that he knew at the time of Ms. Shipione's speech that her husband, Pat Shea, was "angry" at Mayor Murphy and Mr. Kern. Mr. Romano asked how he knew this, and Mr. Kern responded that people told him. He said that Ms. Shipione had been a member of

the SDCERS Board for five years and she had not said anything about the pension problems until then. Mr. Kern did not recall speaking to the Mayor about Ms. Shipione's allegations. Mr. Kern said that he was not sure if Ms. Shipione's speech was political, but he probably asked someone if there was merit to her allegations. Mr. Kern said he may have discussed this with Mr. Gibson, but not Mr. Uberuaga. He did not have any specific recollection that he talked with them about this issue. Mr. Kern said, at that time, the pension underfunding issue did not take up that much of their attention, even though that may be hard to believe in retrospect.

Mr. Romano then inquired about Mr. Kern's experience in the Meet and Confer process. Mr. Kern said that he had ten years of Meet and Confer experience from his prior jobs with various Council members, but he was not involved with it when he worked as Mayor Murphy's chief of staff. He explained that Meet and Confer negotiations were not the place for political people to be, and that he did not really care if the City employees received their benefits through Meet and Confer.

Mayor Murphy's Second Mayoral Campaign

Mr. Romano asked whether the pension problems were an issue in Mayor Murphy's second mayoral campaign. Mr. Kern responded that Mayor Murphy announced in February 2003 that he would be running again, but it was clear that he did not want to run. Mr. Kern said that he and Mayor Murphy had "big fights" about scheduling for the campaign, fundraising, and other issues which made it clear that Mayor Murphy did not have a desire to run. In fact, Mayor Murphy pulled out of the race, but then got dragged back in it around the spring of 2003. Mr. Kern said that during Mayor Murphy's second campaign, he told the Mayor that the pension system was the big issue and they needed to start thinking about what exactly happened. Mr. Kern explained that, as far as the pension was concerned, it was the UAAL, not the underfunding, that was the issue then. Mr. Kern said that they need to figure out what exactly happened, and he was paying more attention to the pension issues at that time than he had in the past. However, Mr. Kern stated that he could not say that the pension was occupying a lot of his time.

Mr. Romano asked if the idea of the PRC had been looming around the time of Mayor Murphy's announcement that he would run again. Mr. Kern stated that it was not. However, he said that something happened in our around June 2003 that caused the creation of the idea for the PRC. Mr. Romano asked if it was the City Manager's reports of June 2003 that he was shown earlier today that caused the creation of the PRC. Mr. Kern said it was possible. Mr. Romano then asked if he had been concerned at all in the summer of 2003 that the City might make a dramatic proposal that revealed how bad the pension problem was before the campaign. Mr. Kern stated that he was unsure whether they thought the PRC would take a year to write its report and stated that it was very methodical and slow. Mr. Romano asked whether there were any recommendations Mr. Uberuaga could make that would have affected Mayor Murphy's election plans, and Mr. Kern said no. He explained that Mayor Murphy did his own reading of the City Manager's reports and had no reservation about going to the Council and defeating the City Manager's recommendations.

Purchase of Service Credits

Mr. Romano showed Mr. Kern Exhibit 9, an October 21, 2002 e-mail from Mr. Kern to Ms. Lexin, copying Mr. Ewell, in which he asked Ms. Lexin to call him concerning an e-mail she sent to him in which discussed changes to the Municipal Code related to purchase of service credits. Mr. Romano asked to what this e-mail was referring. Mr. Kern explained that an ordinance was going to be brought forward that would allow purchased service credits to count towards vesting. At first he said that the e-mail could have been referring to him or someone else, but he later clarified that he believed that the e-mail was referring to his personal interest in buying service credits. He also stated that he thought that Mr. Ewell was also interested in purchasing service credits.

Mr. Kern explained that he had 9.5 years prior City service, but he had not paid into the system, and he was entitled to pay those years plus interest. He set up a "pay-as-you-go" system where he put money into the system every year. Subsequently, Mr. Kern was told that the years he bought were not counted towards vesting but that there would be an ordinance going through that would allow the years purchased to count towards vesting. Mr. Kern believed that was what the e-mail was discussing. He recalled that Mr. Barnett came to his office and gave him the purchase of service credits forms and walked him through it.

Disclosure

Mr. Kern discussed Mr. Roeder's valuations as they appeared in the BRC Report. He said that, in December 2003, he looked at five years of Mr. Roeder's reports and noticed that Mr. Roeder had stated for a while that the retirement system was sound, but then changed his language and assessed it as being adequate. This caused Mr. Kern to "become curious." Mr. Kern noted that while a change in the funded ratio would not make him think something was wrong with the pension system, the change in Mr. Roeder's language choice in his valuations over five years did.

Mr. Romano showed Mr. Kern Exhibit 10, a December 30, 2003 e-mail from Mr. Kern to "Gentlefolk," which most likely included Leslie Girard (Executive City Attorney), Bruce Herring (Deputy City Manager), Cathy Lexin (Human Resources Director), Ms. Frazier, Mr. Ryan and Lisa Irvine (Financial Management Director). Mr. Romano asked whether the Annual Actuarial reports to which Mr. Kern referred in that e-mail were the same ones he had just been discussing; Mr. Kern confirmed that they were. Mr. Romano asked whether the thought occurred to him that the actuary was not being accurate; Mr. Kern said that it did. Mr. Kern said that he had read the valuations in the attempt to try to figure out exactly what was going on. Mr. Romano asked if anyone was helping him to accomplish this, and Mr. Kern said that he was "on his own." He explained that he was trying to understand it for the political campaign because the issue was starting to define Mayor Murphy's administration. The Mayor had not told him to look at these valuations; he initiated his review on his own. Mr. Kern believed that when the big revelation came that the disclosures were wrong it was because no one paid attention to the fact that Mr. Roeder changed his mind in the valuations. He also stated his belief that what happened with the disclosure statements was a "cut and paste job."

Mr. Romano showed Mr. Kern Exhibit 11, a May 24, 2004 e-mail from Mr. Kern to Ms. Frazier and Mr. Gibson and asked whether he read the Mercer Report. Mr. Kern responded, "What's the Mercer Report? I don't have a clue if I got the Mercer Report."

Later in the interview, Mr. Romano asked Mr. Kern to describe the process by which Mayor Murphy's office reviewed bond disclosure documents and Comprehensive Financial Reports. Mr. Kern guessed that the bond documents came to Mayor Murphy's office with the docketed materials. However, he stated that the bond documents may have been delivered separately from the rest of the docketed materials, in which case they would have gone to Ms. Bonavalent, who would put them on Mayor Murphy's desk. Mr. Baber would process the bond documents for Mayor Murphy. Mr. Kern explained that Mayor Murphy would leave his office with a big bag on wheels that contained those documents on a Friday and would review them over the weekend.

Mr. Romano asked whether Mr. Kern discussed disclosure documents with Mayor Murphy; Mr. Kern stated that he did not because Mayor Murphy read them himself; he stated, "why should I read it if he is?" Mr. Kern said he did not talk to Mayor Murphy about the Ballpark disclosure documents. Mr. Kern added that Mayor Murphy read everything and read them carefully. Mr. Kern said he did attend a meeting with Mayor Murphy where he was told to read the Ballpark documents carefully. However, he added that he was not at the closed session in which the Bryan Cave letter discussing disclosure had been discussed.

Mr. Kern said that there had been all different kinds of meetings relating to the Ballpark. However, he noted that there were not community meetings on the Ballpark. He also added that there was an "old boy network" that wanted to have meetings and those people suggested that they should get two underwriters and two lawyers for the project, so if one was not liked they could use the other; Mr. Kern said not to do that. Mr. Kern said these meetings involved negotiations with the Padres. Mr. Romano asked who attended the Ballpark meetings. Mr. Kern stated that the following people attended the meetings: Mr. Barrett and Mr. Jacobs (out-of-town consultants), Mr. Girard, Mr. Herring, Mr. Uberaga, Mr. Ewell, Ms. Frazier, Mr. Ryan, Chris Morris (City Attorney), and outside bond counsel. Mr. Kern said these meetings took place weekly or every couple of days.

Mr. Kern said that he was not involved in drafting the Ballpark documents, and added that he did not even recall seeing those documents. At another point in the interview, Mr. Romano asked whether the Ballpark had been completed by the time Mayor Murphy took office; and Mr. Kern thought that it had not been finished being built at that time. Mr. Romano asked what had delayed the Ballpark from completion. Mr. Kern responded that every time the City was about to issue bonds, someone filed a lawsuit against the City stopping its ability to obtain insurance.

Mr. Romano also asked who attended the rating agency meetings. Mr. Kern said that he, Ms. Frazier and Mr. Ryan attended the meetings and Mayor Murphy probably attended "once or twice." Mr. Kern said that his job at the rating agency meetings was to listen and make suggestions from a political standpoint. Mr. Kern also added he had set up a "backdoor channel" with the Padres that involved the head of the Centre City Development Corporation, Peter Hall. Mr. Romano asked whether Mr. Kern had a background in accounting, and Mr. Kern said that he did not.

Wastewater

Mr. Kern stated that Doug Sain (a communications consultant) had a client named Kelco that was very concerned about changes being proposed to the sewer rates. The Restaurant Association had a big meeting with Mayor Murphy to discuss their problem with how much they were charged for the grease traps they had to use to dispose of waste. The Restaurant Association was threatening to sue. Mr. Kern added that the State had issued a report and there had been a five minute meeting with George Loveland and Richard Mendes (Deputy City Manager) to determine whether to send the report to the Public Utilities Advisory Commission. Mr. Kern noted that one goal of the report dealt with Stormwater runoff. Ms. Blaskey asked Mr. Kern what he recalled about the issue with the State. Mr. Kern responded that Council member Donna Frye had alleged that there was a conspiracy and that Mayor Murphy had hid something. Ms. Blaskey then asked whether Mr. Kern recalled a series of sewer or water rate increases in his first year of office. Mr. Kern responded that he and Mayor Murphy put together the last sewer increase before he was elected to the City Council in 1984. Mr. Kern said that the rate increases were scheduled over a four-year period of time at an increase of 7.5% per year.

Mr. Romano then showed Mr. Kern Exhibit 12, a December 6, 2001 memorandum from the City Attorney to Mayor Murphy and the Council. Mr. Romano asked whether Proposition 218 and the idea of proportionate rates to use sounded familiar to Mr. Kern. Mr. Kern responded that he was not involved in the discussion on that issue, but he was aware that it was going on. He added that Council member Frye made an issue about this, and stated "if you vote no often enough, no one pays attention to you." She had alleged a conspiracy that businesses were "given a break" and residential users had to pay more, and this had been hidden. Mr. Kern said that Mr. Sain thought that his clients were being overcharged. Mr. Kern had no recollection of discussing this issue with Mayor Murphy.

Mr. Romano showed Mr. Kern Exhibit 13, a chain of e-mails from October 21, 2002 between Mr. Girard, Kelly Salt (Deputy City Attorney) and Ms. Frazier. Mr. Romano asked whether Mr. Kern had a role in determining whether an issue could be discussed in closed session; Mr. Kern said that he did not. He added that there had been a fight about that issue once when Mayor Murphy's office thought that the City Attorney controlled the closed session agenda, and the City Attorney thought that it was the Mayor's role to make such decisions. Mr. Romano asked what happened at the meeting with Mr. Girard referred to in Mr. Girard's e-mail. Mr. Kern said that Mr. Girard likely came to him and said that there had been an issue with the releasing of the Cost of Service Study ("COSS") and asked what Mayor Murphy wanted to do about it. Mr. Kern said that he did not recall that meeting or a meeting having to do with the Clean Water Act or Council member Frye.

Mr. Romano then showed Mr. Kern Exhibit 14, a November 8, 2002 e-mail from Dennis Kahlie (Utilities Finance Administrator) to Ms. Frazier and asked whether Mr. Kern knew Mr. Kahlie. Mr. Kern responded that when he worked for Mayor Murphy on the Council and they were working with the rates, they used to get conflicting numbers. He said that Mr. Kahlie always gave the best numbers. Mr. Kern added that he knew Mr. Kahlie for 15 years. He described Mr. Kahlie as being a "true bureaucrat" who was a "great numbers guy" without "a political bone in his body." Mr. Kern said that Mr. Kahlie would not adjust the numbers for

anyone. Mr. Kern also stated that Mr. Kahlie said something to the State about the water issue which Mr. Sain said was political, but it was not.

Mr. Romano read Exhibit 15, Mr. Kahlie's e-mail stating that he would be giving Mr. Kern the attached sewer cost of service compliance issue November 11, 2002 memorandum. Mr. Kern said that he had no recollection of receiving it. Mr. Romano read from the first paragraph of that memorandum, but Mr. Kern stated that the paragraph did not help him recall the City's need to change the sewer rates. Mr. Kern added that if it was on the docket, the odds were "astronomical" that he read the memorandum, and noted that he would have given it to Mayor Murphy. Mr. Kern noted that he only was aware of the accelerated payments because he had read stories about it. He explained that this was a legal issue, and trying to tell Mayor Murphy how to handle a legal issue was not something he would have "wasted" his time with.

Mr. Romano noted Mr. Sain's frustration with the changing rate structure and asked Mr. Kern who Mr. Sain would have reached out to if that issue "became political." Mr. Kern guessed that Mr. Sain probably called him, and he possibly would have referred him to Mr. Story or Mr. Baber. He also noted that Mr. Sain may also have lobbied the Council. Mr. Kern did not recall his conversations on this issue with Mr. Sain. Mr. Romano asked whether Mr. Kern would have met with Mr. Sain had Mr. Sain asked for a meeting; Mr. Kern responded that he would have. Mr. Kern said that he did not know that Kelco had "political muscle." He stated "If you think of political influence in this town, Kelco is not one of them." Mr. Romano asked who was influential in the City. Mr. Kern's response included Qualcomm, the Chamber of Commerce, and unnamed individuals who are influential by virtue of their social standing.

Mr. Romano then showed Mr. Kern Exhibit 16, a November 14, 2002 memorandum from Mary Vattimo (City Treasurer) and Ms. Salt to Mayor Murphy and the Council. Mr. Romano asked if Mr. Kern knew what a COSS was; Mr. Kern said that it "rang a bell." Mr. Kern then added that the exhibit was the COSS that Mr. Loveland was saying to send over to the Public Advisory Committee. Mr. Romano asked whether Mr. Kern would have known about the COSS if it was discussed in closed session; Mr. Kern responded that he would not know.

Mr. Romano next showed Mr. Kern Exhibit 17, a January 22, 2003 from Mr. Loveland to Mr. Mendes and Mr. Kern, attaching a January 21, 2003 e-mail from Leslie Devaney to Ms. Salt, Mr. Loveland, Ms. Frazier, Mr. Mendes, and Mr. Kern. Mr. Romano asked whether Mr. Kern recalled a call with Ms. Devaney about a COSS; Mr. Kern said that he did not. Mr. Kern stated that he only remembered a call with Mr. Loveland on that topic. Mr. Kern said that he was not involved in the decision to conduct a COSS. Mr. Romano asked if a COSS was necessary for a rate increase, and a rate increase was politically sensitive, would it have been brought to Mr. Kern? Mr. Kern stated that he did not recall a political discussion about sewers or rates, but noted that sewage spills related to one of the Ten Goals. Mr. Romano asked what Mr. Kern remembered about his meeting with Mr. Loveland and Mr. Mendes. Mr. Kern stated that he just remembered that there was a meeting to discuss whether the COSS should be sent to the Public Advisory Commission. He did not recall why Mr. Loveland and Mr. Mendes came to him. Mr. Kern thought that the COSS went to the Public Advisory Utilities Commission. Mr. Kern recalled hearing that the City was not in compliance with State regulations. Mr. Kern said that he remembered a call he received from Mr. Sain, but not a letter.

Mr. Romano then showed Mr. Kern Exhibit 18, a May 4, 2004 e-mail from Mr. Sain to Mr. Kern and Mr. Story, and asked Mr. Kern how he responded to Mr. Sain's desire to have a one year extension on the issuance of the COSS. Mr. Kern responded that he would have referred Mr. Sain to Mr. Story. He added that Mr. Story would usually have attended a meeting between Mr. Kern and Mr. Sain. Mr. Kern did not recall Mr. Story being present at the meeting with Mr. Mendes and Mr. Loveland. Mr. Romano questioned whether Mr. Kern recalled any conversations with Mr. Story about the rate structure; Mr. Kern did not recall.

Mr. Romano next showed to Mr. Kern Exhibit 19, a May 7, 2004 e-mail from Mr. Sain to Mr. Kern and Mr. Story and asked how they responded to Mr. Sain's request for them to ask the City Manager to request a one year extension for the State to render a non-compliance decision while the City investigated alternative methods for charging customers for usage. Mr. Kern stated that he was almost certain they would have denied Mr. Sain's request. Mr. Romano then asked what Mr. Kern meant by his e-mail in which he asked Mr. Story, "whadda ya think?" Mr. Kern said that was partially him saying, "Tom this is your issue so you take it." and partially, "Can we do this?" Mr. Romano asked whether Kelco contributed to Mayor Murphy's campaigns. Mr. Kern responded that he was unsure if Kelco was a contributor to either of Mayor Murphy's campaigns. He added that Kelco itself would not have been a contributor, that he thought that Mr. Sain did a fundraiser for Mayor Murphy in his second campaign. He added that hardly anyone contributed to Mayor Murphy's first campaign.

Mr. Romano then showed Mr. Kern Exhibit 20, a string of e-mails from May 17, 2004. One e-mail was from Mr. Kern to Mr. Story. Another e-mail was from Mr. Sain to Mr. Kern. The third e-mail was from Kimberly Wilbur to Mayor Murphy. Mr. Romano asked what Mr. Sain meant when he wrote that he would send Mr. Kern "a list of solutions;" Mr. Kern stated that he had no idea. Mr. Romano then asked what Mr. Kern's reaction would have been to Ms. Wilbur's e-mail in which she noted that Kelco and ISP donated a significant amount to Mayor Murphy's campaign and asked that Mayor Murphy put pressure on the City Manager to request additional time from the State to make its finding of rate non-compliance. Mr. Kern said that his normal reaction to such a letter would have been to say that they would give Kelco and ISP their money back, but he also noted that the entire issue did not "ring any bells." Mr. Kern stated that he liked to bring people in and talk to them to keep the peace, but noted that talking does not mean he was going to do what they are asking for. Mr. Kern then asked what occurred with the rates, and Mr. Romano informed him that the Council increased the rates. Mr. Kern then commented that, apparently, Kelco and ISP did not have a lot of political power. Mr. Romano then showed Mr. Kern Exhibit 21, a May 11, 2004 e-mail from Mr. Kern to Tom Story.

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